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No. 742

IN THE

Supreme Court of the United States

October Term, 1962

H. F. KEELER and ALICE H. KEELER, his wife,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

PETITIONERS' ANSWER TO RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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SUBJECT INDEX

	Page
I. Reply to Argument That Loans in Question Lack Direct and Immediate Relationship to Petitioners' Business	1
II. Respondent's Argument That Here Is "No Conflict" Is Ill-Supported	5
III. Respondent's "Jury Argument"	6
IV. Indemnity Agreement	7
V. *Whipple v. Commissioner*, No. 305, This Term	7
Conclusion	8

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I

REPLY TO ARGUMENT THAT LOSSES IN QUESTION LACK DIRECT AND IMMEDIATE RELATIONSHIP TO PETITIONERS' BUSINESS

The misrepresentation of the major issue in this case at pages 8-9 of Respondent's Brief requires reply. The misrepresentation, a new contention by respondent,[1] was pos-

1. Respondent's trial counsel made an effort at the trial to make it appear that the benefits to petitioner's Seattle business were contingent upon creation of a chain of Canadian laundries. There was some testimony about "chain operation" with no distinction made between the existent loose association of petitioner, Smith, Hoffman and Northern on the one hand, and a future chain of Canadian laundries on the other. However, the evidence clearly indicating that the business benefits flowed directly from the creation of Northern, respondent urged at the trial and in the Court of Appeals only one major point summarized at pages 32-33 in its "Brief for the Appellant" filed in the United States Court of Appeals, stating:

> "This ground of the decision below is erroneous because the true criterion is . . . whether the taxpayer was engaged in the business of making loans or organizing or promoting, financing business enterprises. In the circumstances of this case, this is the only condition which would establish a proximate relationship between the debt and the taxpayer's business. Any other rule would necessarily disregard the corporate entity created by the taxpayer to conduct another business separate from his own."

Accordingly, until this moment, the respondent has contended that this case involves the first question presented in *Whipple v. Commissioner*, certiorari granted, No. 305, this term. Actually, this case involves only the second question nicely stated on page 2 of "Brief for the Respondent" recently filed herein in the *Whipple* case.

sibly inspired by a statement contained on page 8 of the opinion of the Court of Appeals herein. (See Appendix B, petitioners' Petition for Writ of Certiorari.) In a glaring misconception of the facts, the Court of Appeals states at page 8:

> "'Very material benefits' to his Seattle laundry business were anticipated by taxpayer *as a result of the formation of the Canadian chain of laundries.*" (emphasis ours)

Respondent's counsel take up the cudgel gratuitously handed them by the Court of Appeals and now contend that petitioner's losses are not proximately related to his Seattle business because the anticipated benefits to that business were contingent upon a speculative formation of a chain of Canadian laundries—not from Northern itself (Respondent's Brief, p. 8).

All, save one, of the "material benefits" to petitioner's business were either reasonably anticipated or actually realized by petitioner from the formation of Northern. None of these benefits were dependent upon creation of a Canadian chain of laundries. Briefly, the facts are:

Petitioner anticipated "very material benefits" to his Seattle business from the formation of Northern (R. 224). These benefits were: Additional buying power resulting in reduced prices to the Seattle business, the probability of having enough garment purchase volume to justify creating a garment factory further reducing the Seattle plant's costs, highly important exchange of technical in-

formation, and a combination of petitioner, Smith (in Portland), Hoffman (in Milwaukee), and Northern—this "chain," not a Canadian chain—that would deter outsiders from competing with petitioner in Seattle (R. 224). There were also advertising advantages to be gained and reference of large accounts to the Seattle business (R. 251). Petitioner and Smith's Portland laundry actually realized the benefit of additional buying power provided by Northern which "profited them to some extent" (R. 78). In addition, the formation of Northern allowed petitioner to rid himself of $10,000.00 worth of unsalable used equipment (R. 228, 376).

All of these advantages, had they fully materialized, would have been highly beneficial to petitioner's Seattle laundry business and, save the establishment of sufficient garment volume to justify creation of a garment manufacturing business, flowed or were to flow "directly and immediately" (to use the language of counsel for respondent) from the formation of Northern itself. But even the establishment of sufficient garment volume was *not* contingent upon the formation of a Canadian chain of laundries.

About 32% of an industrial laundry's sales are expended in the purchase of cotton goods (R. 79). Petitioner and Smith believed that "substantial savings" (R. 78) could be made by creating a manufacturing unit to supply petitioner, Smith, Hoffman, and Northern. Smith, who had considerable experience in the garment manufacturing business (R. 79), testified such a unit would require the purchase business of laundries having five to six million dollars in gross sales (R. 176 and 181). Smith's Portland

laundry had gross sales of from $1 million to $1.5 million (R. 176). Petitioner's Seattle business was rising from $1.5 million to $3 million in gross sales and Hoffman's Milwaukee business was estimated to be doing about $1 million gross sales (R. 314). Just $½ to $1.5 million gross sales had to be provided by Northern to bring the group's total gross sales to a volume justifying the creation of a manufacturing unit. Respondent's trial counsel unsuccessfully attempted to relate the planned manufacturing unit to the creation of a Canadian chain of laundries. Mr. Smith replied (R. 183):

> "I repeat that the Toronto plant (Northern) of itself could have added that difference in volume between what I had and what, perhaps, Mr. Keeler would want to buy from the plant and what the Toronto plant had, to bring us up to that $5,000,000.00 sales mark."

The original estimates were that Northern would reach $1.5 million in sales in a year and one-half (R. 182-183); after which within 90 days (R. 181) and with only $50,000.00 or $75,000.00 in capital (R. 176), the group (petitioner, Smith, Hoffman and Northern) would have a cost-saving manufacturing unit. Petitioner, who was spending hundreds of thousands of dollars a year (R. 219) purchasing garments for his Seattle business, would have attained an enviable competitive position.

Inherent in respondent's argument is the factual denouement of this case. If, as counsel for respondent contend, losses incurred in pursuit of "fanciful" benefits to flow from a future chain of Canadian laundries, are "too remote" and not "directly and immediately" connected to petitioner's business, then what of losses incurred in

pursuit of real benefits actually flowing and reasonably anticipated to flow from an existent Canadian laundry? Are they also too remote? Respondent's counsel answer not. They do not contend that business benefits reasonably to be anticipated from the creation of Northern are "too remote." They do contend (incorrectly) that petitioner expected benefits only from the creation of a chain of Canadian laundries, and the Canadian chain being too speculative, the benefits are therefore too remote. But this argument would be better saved for clever persuasion of a jury—that jury of which petitioner was denied.

Also, at page 10 of Respondent's Brief, respondent's counsel question whether the anticipated benefits to petitioner's Seattle business were "the dominant consideration" for creating and investing in Northern. One would think that the court would declare the test, and the jury would be allowed to decide the fact. Respondent's trial counsel repeatedly objected to any question concerning motivation that was not answered in terms of "primary purpose" (see, i.e., R. 220). Smith had testified, without prompting, that the anticipated benefits to flow from Northern were "one of the primary reasons that (he) went into the thing (Northern)." (R. 77). Petitioner chose not to use the "magic words," testifying that the anticipated benefits were "a motivating force" in he creating and investing in Northern.

II

RESPONDENT'S ARGUMENT THAT THERE IS "NO CONFLICT" IS ILL-SUPPORTED

Respondent's counsel, at pages 10 and 11 of their brief, cite 15 cases for the erroneous proposition that the opinion

of the Court of Appeals herein does not create conflict. All of the cases cited, except the *Folker* case, which is absolutely inapplicable to the issues and statutes involved herein, are appeals from the Tax Court wherein that court made in each case an ultimate *finding of fact*, supported by substantial but not conclusive evidence, that there was no proximate relationship[2] between the loss or bad debt and the taxpayer's trade or business. The Tax Court is jury as well as court. The cited cases only point out that petitioner was deprived of a jury trial. Respondent's argument causes one to wonder how much "direct and immediate relationship" is required to create a fact question for the jury, as if the cart should pull the horse.

III

RESPONDENT'S "JURY ARGUMENT"

At pages 11 to 15 of Respondent's Brief, respondent's counsel attack petitioner's point that he incurred a loss to obtain release from his guaranty to the bank. In doing so, they vault completely outside the record to cite rejected evidence (p. 12), speculate on what a bank would or would not do under similar conditions (p. 13) and venture that the release was given not because the corporate debt was reduced but was possibly given maybe because someone else paid the bank or substituted his guaranty for petitioners. There is no evidence of this nor is there any evidence that "the bank would probably have dispensed with the guaranty for a token sum" (p. 13) or that the "entire assets of the corporation . . . were subject to the mortgage securing the debt to taxpayer

2. The *O'Neill* and *Holtz* cases turned solely on whether the taxpayer was in the business "of making loans or of promoting, organizing and financing business enterprises."

and Smith" (p. 12) (only the corporation's real estate was—Exhibit 2, R. 70-72) or that "no foreclosure was necessary" (p. 12) or that petitioner and Smith "testified that the amount they received in settlement of their claim was the maximum they could get" (pp. 12-13). The salient fact is that petitioner either had to obtain release from the guaranty, and suffer loss in doing so (the bank exacted a reduction in corporate indebtedness), or he had to pay the guaranty sum, thereby recovering the mortgage, and then bring suit on the increased debt, foreclose the mortgage, and recover an uncertain amount on the unsecured portion of the debt. For reasons of illness, time, distance and inability to raise the guaranty sum, petitioner chose the former option. What tax treatment would obtain if petitioner had chosen the latter option appears irrelevant.

IV

INDEMNITY AGREEMENT

In answer to respondent's argument on pages 15 and 16 of Respondent's Brief, we submit that there *is* a difference between a commitment to acquire stock at its original purchase price and an indemnity agreement to make a person whole by merely paying any loss sustained on that stock. Obviously, the latter, in addition to requiring less money to perform, does not involve the indemnitor in a purchase and sale transaction.

V

WHIPPLE v. COMMISSIONER, NO. 305, THIS TERM

In footnote 3 on p. 8 of Respondent's Brief, respondent's counsel state that this matter does not involve the

question presented in *Whipple v. Commissioner*, No. 305, this term. The second numbered question under "Questions Presented" in the same counsel's "Brief for the Respondent" filed in this court in the *Whipple* case, is a nicely stated version of the same question here involved. However, that question is not nearly as cogent in *Whipple* as it is here. *Whipple* will clear up the confusion concerning cases involving the question whether a taxpayer is "engaged in the business of making loans or organizing, promoting and financing business enterprises." But in all cases the necessary second question, if the first is answered in the negative, is whether the taxpayer's loss was proximately related to his trade or business. The opportunity is thus presented to resolve the confusion in this entire important tax area, not merely in the limited area wherein a taxpayer contends that he is actually in the business of making loans or promoting businesses.

CONCLUSION

It is again respectfully submitted that the petition for writ of certiorari should be granted.

Respectfully submitted,

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